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## BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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AZ CORP COMMISSION  
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In the matter of:

DOCKET NO. S-03413A-01-0000

CLAY EUGENE LAMBERT  
3711 East Minton Place  
Mesa, Arizona 85215  
CRD No. 1959853,

STATE'S BRIEF RE: APPLICABILITY  
OF AUTOMATIC BANKRUPTCY  
STAY, 11 U.S.C. 362(a), TO THIS  
ADMINISTRATIVE PROCEEDING

Respondent.

(ALJ Philip Dion III)

The Arizona Corporation Commission, Securities Division, hereby submits its brief to the Commission as previously ordered by the Administrative Law Judge and requests a finding by the Commission that the administrative proceedings against Respondent are not subject to the automatic stay in Respondent's bankruptcy case. This Brief is supported by the accompanying Memorandum of Points and Authorities.

Respectfully submitted this 31st day of January, 2002.

Janet Napolitano

Attorney General for the State of Arizona

Anthony B. Bingham

Special Assistant Attorney General

Moirra McCarthy

Assistant Attorney General

Attorneys for the Securities Division of the  
Arizona Corporation Commission

1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I. BACKGROUND**

3 On September 26, 2001, the Arizona Corporation Commission, Securities Division ("Division")  
4 issued a Notice of Opportunity For Hearing against Clay Eugene Lambert ("Lambert") alleging fraud in  
5 the sale of unregistered securities to a Phoenix Valley couple, misappropriation of funds from the  
6 couple's business checking account, and other allegations. On October 3, 2001, Lambert requested that  
7 a pre-hearing conference and a hearing be scheduled.

8 On November 6, 2001, Lambert filed a Chapter 13 bankruptcy case in U.S. Bankruptcy Court,  
9 District of Arizona, Phoenix Division. On November 26, 2001, a pre-hearing conference was held. At  
10 the pre-hearing conference, Lambert through his counsel, argued that the administrative proceedings  
11 were stayed due to the automatic stay in bankruptcy, 11 U.S.C. 362(a)(1). The Division argued that 11  
12 U.S.C. 362(b)(4) exempts the administrative proceedings against Lambert from the automatic stay in 11  
13 U.S.C. 362(a)(1) due to the police and regulatory exceptions found in the section. At the pre-hearing  
14 conference, the Administrative Law Judge ("ALJ") requested that both sides submit briefs on whether  
15 the Commission can proceed to a hearing against Lambert, and whether the Commission can order  
16 restitution, penalties, and suspension or revocation of Lambert's Arizona securities registration. After  
17 the hearing, the ALJ issued a written procedural order for each party to submit a brief on the issues  
18 listed in the previous sentence.

19 **II. ARGUMENT**

20 **A. Administrative Proceedings Against Lambert Are Exempt From The Automatic Stay.**

21 The filing of a bankruptcy petition operates as a stay, applicable to all entities, of "the  
22 commencement or continuation . . . of a judicial, administrative, or other action or proceeding against a  
23 debtor . . . ." 11 U.S.C. § 362(a)(1). The general policy behind the automatic stay is to grant complete  
24 and immediate, albeit temporary relief to the debtor from creditors, and to prevent dissipation of the  
25 debtor's assets before orderly distribution to all creditors can be affected. S.E.C. v. Brennan, 230 F.3d  
26 65, 70 (C.A.2 (N.Y.) 2000), quoting Penn Terra Ltd. v. Department of Env'tl. Resources, 733 F.2d 267,

1 271 (3d Cir.1984). A main purpose of the stay is to protect the priority of payment to creditors. 3  
2 COLLIER ON BANKRUPTCY § 362.05[5][b] at 362-61 (15th ed. 2000).

3 Under § 362(b) certain proceedings are excepted from the stay. One of these exceptions is  
4 contained in § 362(b)(4) which allows:

5 The commencement or continuation of an action or proceeding by a governmental  
6 unit . . . to enforce such governmental unit's . . . police and regulatory power, including  
7 the enforcement of a judgment other than a money judgment, obtained in an action or  
8 proceeding by the governmental unit to enforce such governmental unit's . . . police or  
9 regulatory power.

10 Section 362(b)(4) permits the government to initiate or continue an action under its police or  
11 regulatory powers without the restrictions of the automatic stay. 3 Collier on Bankruptcy §  
12 362.05[5][b], at 362-58 (15th ed. 1996); In Re Universal Life Church, Inc., 128 F.3d 1294, 1297 (C.A.9  
13 (Cal.) 1997). The reason for this exception is so bankruptcy does not become “a haven for wrongdoers,  
14 the automatic stay should not prevent governmental regulatory, police and criminal actions from  
15 proceeding.” In Re Universal Life Church, Inc., 128 F.3d at 1297; 3 Collier on Bankruptcy §  
16 362.05[5][a], at 362-54 (15th ed. 1996).

17 The legislative history of § 362(b)(4) indicates that when a governmental unit brings a legal  
18 action against a debtor in order “to prevent or stop violation of fraud, environmental protection,  
19 consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for  
20 violation of such a law, the action or proceeding is not stayed under the automatic stay.” S.Rep. No. 95-  
21 989 at 52 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5838; H.R.Rep. No. 95-595 at 343 (1977),  
22 reprinted in 1978 U.S.C.C.A.N. 5963, 6299; In Re Universal Life Church, Inc., 128 F.3d at 1298  
23 (emphasis added).

24 In determining whether certain actions taken by the government are taken to enforce the  
25 government's police and regulatory power, the courts have distinguished between actions taken to  
26 enforce laws affecting public health, welfare, morals and safety, on one hand, and actions to enforce the

1 state's own pecuniary interests, on the other hand. In re Dunbar, 235 B.R. 465, 471 (9th Cir. BAP  
2 1999); In re Poule, 91 B.R. 83, 86 (9th Cir. BAP 1988). While most government actions have some  
3 pecuniary component, particularly actions related to fraud detection and prevention, this pecuniary  
4 component will not abrogate the government's police power function; only if the action is pursued  
5 solely to advance a pecuniary interest of the government unit will the automatic stay bar it. In re  
6 Dunbar, 235 B.R. at 471; In re Poule, 91 B.R. at 86. The government's interest in punishing such  
7 misconduct as fraud and in preventing such future acts is a valid police and regulatory power. In re  
8 Poule, 91 B.R. at 86.

9 Some debtors in bankruptcy proceedings have argued that the governmental police and  
10 regulatory power exception did not apply to their case because the government was not "exercising  
11 authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use  
12 of Chemical Weapons and on Their Destruction," which, as they argue, is the only police and regulatory  
13 power remaining that is applicable after Congress recently amended § 362. Subsection (b)(4) of § 362  
14 also applies to cases where the Convention Prohibiting Chemical Weapons is not involved. When  
15 Congress recently amended § 362, "... Congress merely expanded and/or redefined the previous police  
16 and regulatory power exceptions to include any organization exercising authority under the Convention  
17 Prohibiting Chemical Weapons." In re PMI-DVM Real Estate Holdings, L.L.P., 240 B.R. 24, 30  
18 (Bkrtcy.D.Ariz. 1999).

19 B. The Commission Can Enter An Order To Cease And Desist, An Order For Penalties and an  
20 Order For Restitution Against Lambert

21 In the Notice of Opportunity For Hearing, the Division seeks a permanent Order To Cease And  
22 Desist, i.e., an injunction, against Lambert to prevent him from future violations of The Securities Act  
23 of Arizona. The Division also seeks penalties and restitution from Lambert for his violations of The  
24 Securities Act of Arizona.

25 In the bankruptcy case of In re Charter First Mortgage, Inc., the Washington State Attorney  
26 General sought injunctive relief against the debtor, civil penalties and restitution of money on behalf of

1 the victims for alleged violations of the Washington Consumer Act. In re Charter First Mortgage, Inc.,  
2 42 B.R. 380 (Bankr.D.Or. 1984). The bankruptcy court concluded that it was appropriate for  
3 Washington to attempt to obtain an injunction and civil penalties for alleged violations of the  
4 Washington Consumer Act, but the state could not attempt to collect on a restitution order. In re  
5 Charter First Mortgage, Inc., 42 B.R. at 384. In the case of In re Poule, a registered contractor argued  
6 that revocation of his license and the civil fines imposed on him by the Registrar of Contractors of the  
7 State California violated the automatic stay in § 362(a)(1). In re Poule, 91 B.R. 83, 85 (9th Cir. BAP  
8 1988). The court held that when a state agency imposes civil penalties on a debtor for fraudulent  
9 conduct or when the state agency is attempting to prevent future fraudulent conduct through injunctive  
10 relief, the action comes within the scope of § 362(b)(4). In re Poule, 91 B.R. at 87 (emphasis added).

11 Once a court determines that a proceeding is excepted from the automatic stay by § 362(b)(4),  
12 the court can allow the governmental unit to fix the amount of penalties, up to and including entry of a  
13 money judgment. S.E.C. v. Brennan, 230 F.3d 65, 71-2 (C.A.2 (N.Y.) 2000). These cases and other  
14 cases hold that “anything beyond the mere entry of a money judgment against a debtor is prohibited by  
15 the automatic stay.” Brennan, 230 F.3d at 71. This is consistent with language in § 362(b)(4), “. . .  
16 including the enforcement of a judgment other than a money judgment . . . .” Of course, the proceeding  
17 in which the money judgment is entered must be one to enforce the governmental unit’s police or  
18 regulatory power. Brennan, 230 F.3d at 71.

19 Likewise, the Commission can enter a restitution Order against Lambert for his violations of The  
20 Securities Act of Arizona. However, like with penalties, the Securities Division cannot attempt to  
21 collect on the restitution order.

### 22 C. The Commission Can Suspend Or Revoke Lambert’s Arizona Securities Registration

23 Just as the State Bar of Arizona’s disciplinary proceedings and the suspension from the practice  
24 of law of an Arizona licensed attorney are excepted by § 362(b)(4), on the basis that they are an exercise  
25 of regulatory power by a governmental unit, the administrative proceedings against Lambert and the  
26 possible future suspension or revocation of his Arizona registration to sell securities are excepted from

1 the automatic stay of § 362(a). In re Wade, 948 F.2d 1122, 1123-24 (C.A.9 (Cal.) 1991); Matter of  
2 Wade, 168 Ariz. 412, 423, 426, 814 P.2d 753 (1991). One day after Mr. Wade filed a Chapter 11  
3 bankruptcy petition, the State Bar of Arizona initiated disciplinary proceedings against Mr. Wade for  
4 alleged violations of ethical rules. The United State Court of Appeals, Ninth Circuit, held that the  
5 disciplinary proceedings against Mr. Wade were excepted from the automatic stay under 11 U.S.C. §  
6 362(b)(4). In re Wade, 948 F.2d at 1124. The State Bar of Arizona suspended Mr. Wade's license to  
7 practice law and Mr. Wade appealed the decision to the Supreme Court of Arizona. The Supreme Court  
8 of Arizona upheld Mr. Wade's suspension from the practice of law and commented that "There was,  
9 and is, no reason to stay respondent's disciplinary matter because of his bankruptcy petition." Matter of  
10 Wade, 168 Ariz. at 423.

11 The U.S. Bankruptcy Appellate Panel of the Ninth Circuit has upheld the revocation by the State  
12 of California of a contractor's license. In re Poule, 91 B.R. 83, (9th Cir. BAP 1988). The contractor  
13 filed a petition for relief under Chapter 11 of the Bankruptcy Code. Approximately three months later,  
14 the Registrar of Contractors of the State of California issued a citation against the contractor. After the  
15 citation was issued and the contractor failed to appear at a hearing, the Registrar revoked the  
16 contractor's license. Subsequently, the contractor filed a motion in bankruptcy court asking the court to  
17 set aside the revocation of his contractor's license. The debtor argued that the license revocation was  
18 void because the action was subject to the Bankruptcy Code's automatic stay. The bankruptcy judge  
19 found, and the 9th Circuit Bankruptcy Appellate Panel affirmed, that ample grounds existed for  
20 revoking the contractor's license and the conduct of the Registrar was exempted from the automatic stay  
21 by section 362(b)(4) as a proceeding by a governmental unit to enforce police or regulatory powers. In  
22 re Poule, 91 B.R. at 85.

23 Based upon the holdings and reasoning in the two cases cited above, In re Wade and In re Poule,  
24 and the language in § 362(b)(4), the Commission can suspend or revoke Lambert's Arizona registration  
25 to sell securities. This is regardless of Lambert's Chapter 11 bankruptcy case and the applicable  
26 automatic stay.

1           D. The Commission Can Determine The Applicability of § 362(a) To This Proceeding

2           The court in which litigation is pending has jurisdiction to determine whether the proceeding  
3 before it is subject to the automatic stay. S.E.C. v. Bilzerian, 131 F.Supp.2d 10, 14 (D.D.C. 2001);  
4 NLRB v. Sawulksi, 158 B.R. 971, 975 (E.D.Mich.1993). The court in Bilzerian, as many other courts  
5 must do, had to first address whether the proceeding before it was affected by the automatic stay  
6 provision found in § 362(a). Bankruptcy courts do not have exclusive jurisdiction in determining the  
7 applicability of the automatic stay. S.E.C. v. Bilzerian, 131 F.Supp.2d at 14; In re Montana, 185 B.R.  
8 650, 652 (Bankr. S.D.Fla. 1995); NLRB v. Sawulksi, 158 B.R. at 975. Therefore, the Commission has  
9 jurisdiction to determine whether the automatic stay applies to this administrative case.

10           Furthermore, the Arizona Attorney General provides expertise and advice on interpretations of  
11 laws, both federal and state, to state agencies. The Bankruptcy and Collections Section of the Attorney  
12 General's Office has knowledge concerning federal bankruptcy issues, particularly the applicability of §  
13 362(a) and (b)(4). A memo setting forth the Arizona Attorney General's position on the automatic stay  
14 as it applies to administrative proceedings is attached as Exhibit "A."

15   **III. CONCLUSION**

16           For the above reasons, the Division requests that the ALJ make a determination that the  
17 administrative proceedings in this matter are exempt from the automatic stay provision of the  
18 bankruptcy code, that the Commission can enter an order to cease and desist, an order for penalties and  
19 an order for restitution against Lambert, and that the Commission can suspend or revoke Lambert's  
20 registration to sell securities in Arizona. The Division acknowledges that any order entered against  
21 Lambert for penalties and restitution will be subject to applicable bankruptcy laws for purposes of  
22 collection.

23   ...

24   ...

25   ...

26   ...

1 Original and ten copies  
2 of the foregoing hand-delivered  
3 this ~~3/5~~ day of January, 2002 to:

4 Docket Control  
5 Arizona Corporation Commission  
6 1200 W. Washington St.  
7 Phoenix, AZ 85007

8 A copy of the foregoing hand-delivered/mailed  
9 this ~~3/5~~ day of January, 2002 to:

10 Philip J. Dion III  
11 Administrative Law Judge  
12 Arizona Corporation Commission  
13 1200 W. Washington St.  
14 Phoenix, AZ 85007

15 Michael Salcido  
16 Gust Rosenfeld P.L.C.  
17 201 N. Central Ave., Ste. 3300  
18 Phoenix, AZ 85073-3300  
19 Attorneys for Respondent  
20  
21  
22  
23  
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**ARIZONA ATTORNEY GENERAL  
AGENCY COUNSEL DIVISION  
M E M O R A N D U M**

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**TO:** Administrative Law Judge  
**FROM:** Robert R. Hall, Assistant Attorney General, Bankruptcy and  
Enforcement Collection Section  
**RE:** Application of the Automatic Stay of 11 U.S.C. 362(a)  
to administrative hearings  
**DATE:** JANUARY 31, 2002

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This memorandum concerns whether an administrative hearing can proceed against a party who has filed a bankruptcy petition. It is the opinion of this office that the hearing can proceed provided that there is no attempt to enforce a monetary award against property of the bankruptcy estate. In reaching this conclusion, the following factors have been considered:

When a bankruptcy petition is filed, two significant events occur which alter the rights of both the Debtor and creditors. The first is the creation of the bankruptcy estate under 11 U.S.C. §541. The estate consists of virtually all property rights of the Debtor. The second is the imposition of the automatic stay under 11 U.S.C. 362(a). This provision, with important exceptions, prohibits acts, which seek to collect debts against property of the bankruptcy estate.

11 U.S.C. 362(a) is modified by 362(b). The latter section states specific situations in which the automatic stay does not apply. The significance of this section is that the party seeking to enforce its non-bankruptcy rights does not need to seek approval from the bankruptcy court because the stay does not apply to the action the party is taking.

There are 18 separate provisions in 362(b). Of significance to this memorandum is 362(b)(4). This provision permits a governmental unit to commence litigation for police or regulatory purposes against a debtor and to enforce a nonmonetary judgement against the Debtor. The bankruptcy code and supporting case law differentiate the government's police power from its ability to collect on a debt (pecuniary power). Provided that the court's relief relates to the police power (injunction against future acts and the liquidation of damages) and does not involve an attempt to collect the damages (pecuniary action), the automatic stay does not apply to this proceeding. Since the automatic stay does not apply to this administrative hearing, it is appropriate for this court to continue its function.